

UNITED STATES DISTRICT COURT
NORTHERN DISTRICT OF CALIFORNIA

In re OMNIVISION TECHNOLOGIES, INC.) No. C-04-2297 SC
and related cases.)
ORDER RE: DEFENDANTS'
MOTION TO DISMISS THE
SECOND CONSOLIDATED
AMENDED COMPLAINT

I. INTRODUCTION

Lead Plaintiffs ("Plaintiffs") have brought this class action against Defendant OmniVision Technologies, Inc. ("OmniVision") and Individual Defendants Shaw Hong, Raymond Wu, H. Gene McCown, and John Rossi ("Individual Defendants"). Defendants seek dismissal of the Second Consolidated Amended Complaint ("SCAC") in its entirety pursuant to Federal Rules of Civil Procedure 9(b) and 12(b)(6) and the Private Securities Litigation Reform Act, 15 U.S.C. § 78u-4 ("PSLRA"). For the reasons described herein, the Court hereby DENIES the Motion in its entirety.

II. BACKGROUND

OmniVision is a Delaware corporation headquartered in Sunnyvale, California. Motion at 3. OmniVision develops and sells semiconductor image sensor devices used in mobile phones, digital still cameras, and video game consoles. Id. Individual Defendants are directors and officers at OmniVision. Id.

On June 9, 2004, OmniVision announced that it was carrying out a review of previously released financial results. Id. The review dealt with improper revenue recognition methods. Although the review was expected to lead to an upward revision of the financial results for certain quarters, damage to confidence in OmniVision's accounting practices led to a sharp sell-off in its stock. Opposition at 2. OmniVision eventually restated its financial results for the quarters ended July 31, 2003; October 31, 2003; and January 31, 2004. Motion at 4.

The class period runs from June 11, 2003 to June 9, 2004. SCAC at 1. Plaintiffs allege that over this period preceding the June 9, 2004 announcement, Defendants deliberately delayed recognition of certain revenues and income so as to smooth out OmniVision's earnings and mask the impact of competition on its growth rate. Id. Plaintiffs also allege that the Individual Defendants sold significant amounts of stock at prices that were artificially inflated because of the earnings manipulation. Id. at 2.

The Second Consolidated Amended Complaint puts forth two causes of action. The first is brought against all Defendants pursuant to Section 10(b) of the Securities Exchange Act of 1934. The second is brought against the Individual Defendants pursuant to Section 20(a) of the Act.

III. LEGAL STANDARD

Under Rule 12(b)(6) of the Federal Rules of Civil Procedure, a party may move for dismissal "for failure to state a claim upon which relief can be granted." When presented with a motion to

1 dismiss, "[a]ll allegations of material fact are taken as true and
2 construed in the light most favorable to the nonmoving party."
3 Jacobellis v. State Farm Fire & Cas. Co., 120 F.3d 171, 172 (9th
4 Cir. 1997). "[A] complaint should not be dismissed for failure to
5 state a claim unless it appears beyond doubt that the plaintiff
6 can prove no set of facts in support of his claim which would
7 entitle him to relief." Conley v. Gibson, 355 U.S. 41, 45-46
8 (1957); see also Gompper v. VISX, Inc., 298 F.3d 893, 896 (9th
9 Cir. 2002).

10 Defendants also rely on Rule 9 of the Federal Rules of Civil
11 Procedure to support their Motion. Rule 9 states, "In all
12 averments of fraud or mistake, the circumstances constituting
13 fraud or mistake shall be stated with particularity."

14 Plaintiffs' claims are brought pursuant to Sections 10(b) and
15 20(a) of the Exchange Act. The PSLRA controls the pleading
16 standards for these claims. In re Silicon Graphics, 183 F.3d 970,
17 973 (9th Cir. 1999). Under the PSLRA, a plaintiff "must plead, in
18 great detail, facts that constitute strong circumstantial evidence
19 of deliberately reckless or conscious misconduct." Id. at 974.
20 More specifically, a plaintiff "is required to state with
21 particularity all facts giving rise to a 'strong inference' of the
22 required state of mind." Id. at 983.

23 The Court notes that "an inevitable tension arises between
24 the customary latitude granted the plaintiff on a motion to
25 dismiss under Fed. R. Civ. P. 12(b)(6), and the heightened
26 pleading standard set forth under the PSLRA." Gompper, 298 F.3d
27 at 896. The Ninth Circuit, resolving this tension with a tilt
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1 toward the heightened pleading standard of the PSLRA, has stated
2 that "to consider only inferences favorable to [plaintiffs']
3 position would be to eviscerate the PSLRA's strong inference
4 requirement." Id. at 896. Rather than considering only
5 inferences in favor of plaintiffs, "the court must consider *all*
6 reasonable inferences to be drawn from the allegations, including
7 inferences unfavorable to the plaintiffs." (emphasis in original)
8 Id. at 897. In other words, "[t]he heightened pleading
9 requirements of the Private Securities Litigation Reform Act are
10 an unusual deviation from the usually lenient requirements of
11 federal rules pleading." Ronconi v. Larkin, 253 F.3d 423, 437
12 (9th Cir. 2001). As stated in Ronconi, "[f]or a securities fraud
13 case based on false statements to survive a motion [to dismiss],
14 the pleading has to state particularized facts that, taken as a
15 whole, raise a strong inference that defendants intentionally or
16 with deliberate recklessness made false or misleading statements
17 to investors." Id.

18 **IV. DISCUSSION**

19 "To avoid dismissal under the PSLRA, the Complaint must
20 specify each statement alleged to have been misleading [and] the
21 reason or reasons why the statement is misleading ..." Nursing
22 Home Pension Fund v. Oracle Corp., 380 F.3d 1226, 1230 (9th Cir.
23 2004) (internal citations and quotations omitted). "In addition,
24 the PSLRA requires that the Complaint state with particularity
25 facts giving rise to a strong inference that the defendant acted
26 with the required state of mind, or scienter." Id. (internal
27 citations and quotations omitted). A complaint must be dismissed
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1 if either of these two prongs are not met. Id. Defendants assert
2 that Plaintiffs have failed to meet both prongs. Furthermore,
3 Defendants assert that the individual defendants are not liable
4 for any statements that they did not make. Finally, Defendants
5 assert that Plaintiffs failed to allege that their economic losses
6 were caused by OmniVision's restatements. The Court will consider
7 each of these arguments in turn.

8 A. Whether the Complaint describes misleading statements

9 It is undisputed that OmniVision engaged in revenue
10 recognition practices which resulted in a restatement of revenues
11 and earnings for the financial reporting periods covered by the
12 class period. Motion at 3-5. OmniVision eventually restated
13 earnings results for the quarters ended July 31, 2003; October 31,
14 2003; and January 31, 2004. Motion at 4. Given that the
15 financial results for these periods were restated, the originally
16 announced results were clearly misleading. "Properly pled,
17 overstating of revenues may state a claim for securities fraud
18 ..." Hockey v. Medhekar, 30 F. Supp. 2d 1209, 1216 (N.D. Cal.
19 1998). Here, the allegations concern understating of revenue, but
20 Defendants' argument that there is a distinction between
21 overstatements and understatements of revenue is simply not
22 credible. The one third drop in OmniVision's stock price on June
23 9, 2004 overwhelmingly demonstrates that the investing community
24 finds improper revenue recognition incidents to be serious matters
25 regardless of the direction of the improper recognition.
26 Therefore, this Court holds that Plaintiffs have sufficiently
27 plead facts showing that Defendants issued misleading statements.

1 Of course, this alone cannot defeat dismissal. "[T]he mere
2 publication of inaccurate accounting figures, or a failure to
3 follow GAAP, without more, does not establish scienter." Provenz
4 v. Miller, 102 F.3d 1478, 1490 (9th Cir. 1996) (internal citations
5 and quotations omitted). As discussed in the following section,
6 the Court finds that the allegations of scienter are sufficient to
7 defeat dismissal.

8 B. Whether the Complaint alleges scienter

9 As a preliminary matter, the Court notes the connection
10 between a § 10(b) claim and a § 20(a) claim. "Scienter is an
11 essential element of a § 10(b) or Rule 10b-5 claim. And to
12 prevail on their claims for violations of § 20(a) ..., plaintiffs
13 must first allege a violation of § 10(b) or Rule 10b-5. Absent
14 pleading scienter with particularity, there can be no liability"
15 on either the § 10(b) claim or the § 20(a) claim. Lipton v.
16 Pathogenesis Corp., 284 F.3d 1027, 1035 (9th Cir. 2002) (internal
17 citations and quotations omitted). In other words, dismissal of
18 the § 10(b) claim necessitates dismissal of the § 20(a) claim as
19 well. Similarly, allegations sufficient to support a § 10(b)
20 claim provide strong support for a corresponding § 20(a) claim.
21 Therefore, the Court will focus its analysis on the § 10(b) claim.

22 Turning to the legal definition of the element of scienter
23 applicable here, the PSLRA's "required state of mind," in 15
24 U.S.C. § 78u-4(b)(2), "refers to the scienter requirement
25 applicable to [a section 10b claim]." In re Silicon Graphics, 183
26 F.3d at 975. The PSLRA states, "In any private action arising
27 under this title in which the plaintiff may recover money damages
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1 only on proof that the defendant acted with a particular state of
2 mind, the complaint shall ... state with particularity facts
3 giving rise to a strong inference that the defendant acted with
4 the required state of mind." 15 U.S.C. § 78u-4(b)(2). The Ninth
5 Circuit has held that "the PSLRA language that the particular
6 facts must give rise to a strong inference of the required state
7 of mind [means] that the evidence must create a strong inference
8 of, at a minimum, 'deliberate recklessness.'" In re Silicon
9 Graphics, 183 F.3d at 977 (internal quotations omitted). A
10 plaintiff bringing a claim controlled by the PSLRA, as Plaintiffs
11 do here, "can no longer aver intent in general terms of mere
12 'motive and opportunity' or 'recklessness,' but rather, must state
13 specific facts indicating no less than a degree of recklessness
14 that strongly suggests actual intent." Id. at 979.

15 "Scienter can be established by direct or circumstantial
16 evidence." Provenz, 102 F.3d at 1490. The preferable way for a
17 plaintiff to show scienter is by putting forth contemporaneous
18 reports or data which contradict the allegedly misleading
19 statements. Nursing Home Pension Fund, 380 F.3d at 1230.
20 Plaintiffs here have put forth a variety of arguments to support
21 their allegations of scienter. For example, Plaintiffs allege
22 that "the restatement and GAAP violations create an inference of
23 scienter." Opposition at 10. However, as stated above, "the mere
24 publication of inaccurate accounting figures, or a failure to
25 follow GAAP, without more, does not establish scienter." Provenz,
26 102 F.3d at 1490. Alternatively, Plaintiffs suggest that
27 OmniVision's muddled explanations of its improper accounting at
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1 the time of the restatement and its unstable upper management
2 ranks during the class period support an inference of scienter.
3 Opposition at 14-16. However, the Court finds these arguments to
4 be insufficient under the heightened pleading requirements of the
5 PSLRA.

6 An alternative method of showing an inference of scienter
7 involves insider trading data. "[I]nsider trading in suspicious
8 amounts or at suspicious times is probative of scienter."
9 Provenz, 102 F.3d at 1491 (internal citations and quotations
10 omitted). Generally speaking, under Ninth Circuit law, "[s]tock
11 trades are only suspicious when dramatically out of line with
12 prior trading practices at times calculated to maximize the
13 personal benefit from undisclosed inside information." Nursing
14 Home Pension Fund, 380 F.3d at 1232 (internal citations and
15 quotation omitted). "To evaluate suspiciousness of stock sales,
16 [a court considers] three factors: (1) the amount and percentage
17 of shares sold; (2) timing of the sales; and (3) consistency with
18 prior trading history." Id.

19 Plaintiffs have detailed a series of stock sales by the
20 Individual Defendants. For example Defendant Hong sold 18% of his
21 shares during the class period, but only 7% of his shares in the
22 year earlier period. SCAC at 43. Defendant Wu sold 64% of his
23 shares in the class period, but only 29% of his shares in the year
24 earlier period. Id. Defendants McCown and Rossi sold 100% of
25 their shares during the class period. Id. at 44. These
26 percentages, the timing, and the inconsistency with prior trading
27 history all support a finding of an inference of scienter for
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1 purposes of this Motion. In particular, two of the Individual
2 Defendants more than doubled the relative proportion of their
3 shares they sold during the class period. The other two simply
4 sold all of their shares. The Court finds that these sales meet
5 the "dramatically out of line" standard described in Nursing Home
6 Pension Fund.

7 The Court recognizes that "credible and wholly innocent
8 explanations for stock sales, ranging from long-standing programs
9 of periodic divestment, to the need to free cash to meet matured
10 tax liabilities [if unrebutted] are sufficient to defeat any
11 inference of bad faith." Provenz, 102 F.3d at 1491 (internal
12 citations and quotations omitted). Tellingly, Defendants have
13 offered no such explanations. Reply at 12-13. Rather, Defendants
14 rely on their misconstrued theory that because this case involves
15 earnings understatements, instead of overstatements, insider sales
16 are not indicative of scienter. For example, Defendants state,
17 "If, in fact, defendants were causing financial results (and hence
18 OmniVision's stock price) to be artificially deflated in the
19 current period, so that it would be higher in future periods,
20 there would be no reason to sell stock in the current period."
21 Reply at 12. This statement is a dramatic misconception of how
22 stock markets function as demonstrated by the movement of
23 OmniVision's stock on June 9, 2004. Clearly, the investing
24 community does not view improper revenue recognition resulting in
25 understated earnings in the same light as Defendants because the
26 share price of OmniVision fell by approximately one third on June
27 9, 2004 when the company first announced its accounting problems.

1 In light of the above, the Court finds that Plaintiffs have
2 demonstrated an inference of scienter sufficient to meet the
3 heightened pleading requirements of the PSLRA and defeat this
4 Motion to Dismiss.

5 C. Individual defendants' liability for others' statements

6 The parties disagree over the applicability and extent of the
7 "group pleading doctrine." Under the group pleading doctrine,
8 there is "a presumption that the allegedly false and misleading
9 'group published information' complained of is the collective
10 action of officers and directors." Berry v. Valence Tech.,
11 Inc. 175 F.3d 699, 706 (9th Cir. 1999). The Court has found no
12 case law to suggest that this doctrine does not apply here. It is
13 true that the Ninth Circuit has limited the doctrine in cases of
14 directors' liability to situations where a director participated
15 in day-to-day corporate control or had some other special
16 relationship with the corporation. Id. However, this limitation
17 is moot here since all four Individual Defendants were executives
18 with day-to-day responsibilities at OmniVision. Therefore, the
19 Court holds that at this time the group pleading doctrine does
20 apply. However, with respect to Defendants McCown and Rossi, who
21 were CFOs of OmniVision for different sub-periods of the class
22 period, the Court cautions Plaintiffs that the potential liability
23 of an Individual Defendant for statements attributable to the
24 corporation or other individuals is limited by when that defendant

1 served in a position encompassed by the group pleading doctrine.¹

2 D. Whether complaint alleges economic losses

3 On April 20, 2005, Defendants' original Motion to Dismiss was
4 vacated by this Court subsequent to the Supreme Court's holding in
5 Dura Pharmaceuticals, Inc. v. Broudo, 125 S. Ct. 1627, 161 L. Ed.
6 2d 577, 2005 U.S. LEXIS 3478 (April 19, 2005), that plaintiffs in
7 a securities fraud action must show that they "suffered actual
8 economic loss." An "'artificially inflated purchase price' is not
9 itself a relevant economic loss." Id. *19. Rather, where the
10 facts suggest that false or misleading statements led to an
11 artificially inflated purchase price, the complaint cannot fail to
12 allege that the "share price fell significantly after the truth
13 became known." Id.

14 Plaintiffs' Amended Complaint of November 23, 2004 merely
15 alleged that "members of the Class acquired OmniVision securities
16 during the Class Period at artificially high prices and were
17 damaged thereby." Consolidated Complaint at 42. This was
18 insufficient under Broudo. The Second Consolidated Amended
19 Complaint now before the Court alleges, "Plaintiffs purchased
20 OmniVision securities at artificially inflated prices and suffered
21 damages when revelation of the true facts caused a decline in the
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23 ¹ As to the attempt to limit Defendant Wu's liability, the
24 argument put forward by Defendants is at best unclear. Defendants
25 state, "Contrary to the [Complaint], with the exception of the 2003
26 10-K and the secondary offering documents, Mr. Wu did not sign any
27 of the SEC filings challenged by plaintiffs." Motion at 23. These
28 are two rather large exceptions. While the Court recognizes that
the 2003 10-K concerned past results which did not fall within the
class period, clearly the secondary offering documents were
concerned with revenue recognition methods during the class period.

1 value of their investments." SCAC at 49. The Court finds this to
2 be a sufficient allegation of economic loss as required under the
3 Broudo standard described above.

4 **V. CONCLUSION**

5 The PSLRA and Rule 9(b) of the Federal Rules of Civil
6 Procedure require a heightened standard of pleading and
7 particularity with regard to securities class actions. Here,
8 these pleading requirements are met by the Second Consolidated
9 Amended Complaint. It is uncontested that Defendant OmniVision
10 engaged in accounting procedures which led to earnings
11 restatements for several periods. It is also uncontested that the
12 executives in charge at the time engaged in a pattern of share
13 sales that was distinguishable from earlier sales. While these
14 facts alone do not prove by themselves any liability on the part
15 of the entity or Individual Defendants, the Court holds them to be
16 sufficient to defeat the instant Motion. Therefore, the Court
17 DENIES Defendant's Motion to Dismiss in its entirety. It is
18 further ordered that the parties are to appear on September 16,
19 2005 at 10 a.m. in Courtroom Number 1 for a status conference.
20 The parties are to file one joint status conference statement 7
21 days prior to the conference.

22 IT IS SO ORDERED.

23 Dated: July 29, 2005

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25 /s/ Samuel Conti

26 UNITED STATES DISTRICT JUDGE
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